IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

IN RE:	§	
	§	
FFP OPERATING PARTNERS, L.P.	§	**CASE NO. 03-90171-BJH-11**
	§	
	§	
Debtor.	§	
	§	

MEMORANDUM OPINION AND ORDER

Before the Court is the Motion to Require Debtor to Perform Lease Obligations pursuant to § 365(d)(3) or, Alternatively, to Assume or Reject Leases (the "Motion") filed by the Lessors.[1] The Court has core jurisdiction over the Motion pursuant to 28 U.S.C. §§ 1334 and 157(b).

Factual Background And Contentions of the Parties

Prior to the commencement of its Chapter 11 bankruptcy case (the "Case") on October 23,

[1]Any capitalized term not defined in this Memorandum Opinion and Order shall have the meaning ascribed to it in the Motion.

2003, the Debtor operated several hundred convenience stores on premises leased from various third parties. While the Debtor sought to reject certain of those leases shortly after the commencement of the Case, it also sought an extension of the time within which it may make decisions to assume or reject its remaining leases under the Bankruptcy Code.[2] The Court has extended the time period for assumption or rejection of the remaining nonresidential real property leases of the Debtor. At present, the Debtor must make decisions with respect to the Leases by August 28, 2004.

One of the Lessors is the landlord under one of the Leases and the Debtor is the tenant under all of the Leases. The Debtor operates a convenience store on each piece of real property covered by the Leases. An "illustrative" lease agreement was attached to the Motion. From this lease agreement, it appears that the Leases obligate the Debtor to pay rent, taxes, utilities, and other expenses; to make repairs; to indemnify the Lessors from certain claims; and to defend the Lessors in litigation when it is filed.

In the Motion, the Lessors seek to require the Debtor to "perform all post-petition obligations accruing on the Leases." *See* Motion at ¶ 11. In particular, the Lessors ask this Court to order the Debtor to pay the 2003 real estate taxes owing under the Leases and to escrow funds monthly to pay the real estate taxes that are accruing for 2004. With respect to the 2003 real estate taxes, the Lessors contend that because the Debtor's obligation to pay those taxes under the Leases arose after the commencement of the Case, the Debtor is obligated by § 365(d)(3) to pay all taxes owing for the year notwithstanding the fact that the Debtor commenced this Case in late October 2003. With respect to real estate taxes for 2004, the Lessors assert that the Debtor should be required, as a condition of extending the time for assumption or rejection of the Leases, to escrow funds for the

[2]The Debtor's requests for an extension of the time period to make decisions to assume or reject the Leases was the subject of a prior Memorandum Opinion and Order of this Court and is currently on appeal to the District Court.

payment of the 2004 taxes.

Conversely, the Debtor, the Official Unsecured Creditors' Committee, and various secured creditors oppose the particular relief requested in the Motion (collectively, the "Opponents"), contending that since a substantial amount of the 2003 taxes accrued prior to the commencement of the Case, at most the Debtor is required by § 365(d)(3) to pay that portion of the taxes which accrued after the commencement of the Case. With respect to 2004 taxes, the Opponents contend that since § 365(d)(3) only requires the Debtor to perform lease obligations arising "from and after the order for relief," the absence of any obligation to escrow for real estate taxes in the Leases precludes the grant of this relief to the Lessors.

In short, the parties disagree over the correct interpretation of § 365(d)(3) as it relates to the payment of 2003 real estate taxes, some of which are for a time period prior to the commencement of the Case and some of which are for a time period after the commencement of the Case. It is unsurprising that the parties disagree, since there is no agreement among the courts which have addressed the specific question at issue here.

Legal Analysis

Section 365(d)(3) of the Bankruptcy Code provides that "the trustee shall timely perform all the obligations of the debtor . . . arising from and after the order for relief under any unexpired lease . . . , until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title." 11 U.S.C. § 365(d)(3). In a case factually similar to this one, the court in *Centerpoint Props. v. Montgomery Ward Holding Corp. (In re Montgomery Ward Holding Corp.)*, 268 F.3d 205, 208-209 (3rd Cir. 2001) stated the issue as follows:

> [t]he issue for resolution then is what Congress meant when it referred to 'obligations of the debtor arising under a lease after the order of relief.' [sic] In the factual

> context of this case, does it require payment by the trustee of all amounts that first become due and enforceable after the order [for relief] under the terms of the lease? Or does it require the proration of such amounts based upon whether the landlord's obligation to pay the taxes accrued before or after the order [for relief]?"

Recognizing that some courts have followed a proration approach, the *Montgomery Ward* court rejected that approach as being "inconsistent with what would appear to be the fundamental tenet of the text – that it is the terms of the lease that determine the obligation and when it arose, " *id*. at 209-10, and concluded that

> [t]he clear and express intent of § 365(d)(3) is to require the trustee to perform the lease in accordance with its terms. To be consistent with this intent, any interpretation must look to the terms of the lease to determine both the nature of the "obligation" and when it "arises." If one accepts this premise, it is difficult to find a textual basis for a proration approach. On the other hand, an approach which calls for the trustee to perform obligations as they become due under the terms of the lease fits comfortably with the statutory text.

Id. at 209. "Finding a straightforward interpretation [of § 365(d)(3)] that produces a rational result and no other reasonable interpretation consistent with the text," the *Montgomery Ward* court concluded it was "constrained to hold that § 365(d)(3) is not ambiguous." *Id*. at 210. Finally, the *Montgomery Ward* court noted that

> [w]e reach the conclusion that § 365(d)(3) is unambiguous with some reluctance given that one sister court of appeals and a number of other courts have reached the opposite conclusion and have opted for a proration approach. Nevertheless, we find ourselves unpersuaded by the contentions that have led them to their conclusion. We acknowledge that there are aspects to a proration approach that Congress might have found desirable. It is not our role, however, to make arguably better laws than those fashioned by Congress. We also acknowledge that proration was the pre-Code practice and that we had been admonished not to 'read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.' It seems clear to us, however, that Congress enacted § 365(d)(3) for the purpose of altering a pre-Code practice that had created a problem for landlords of non-residential property and that our task is to determine the nature of the change based on the text chosen. Finally, we acknowledge that the result we reach may in some cases leave room for strategic behavior on the part of landlords and tenants. Here, we tender only two observations. Tax reimbursements are only a small constellation in the universe of obligations coming within the scope of § 365(d)(3),

> and there is no basis in the text for distinguishing them from rent and numerous other obligations of tenants. Moreover, strategic behavior even in the area of tax reimbursements can be constrained by forethought and careful drafting.

Id. at 211-212 (citations omitted).

Somewhat reluctantly, this Court agrees with the analysis and holding of the *Montgomery Ward* court. Like the *Montgomery Ward* court, this Court recognizes the fairness of the proration approach used under the former Bankruptcy Act. However, this Court concludes, as did the *Montgomery Ward* court, that a proration approach cannot be squared with the language Congress actually chose when it adopted § 365(d)(3).

Since the *Montgomery Ward* court's analysis has been criticized by other courts which have chosen to follow a proration approach, *see, e.g., In re Furr's Supermarkets, Inc.*, 283 B.R. 60 (10th Cir. BAP 2002); *In re Ames Dep't Stores, Inc.*, 306 B.R. 43 (Bankr. S.D.N.Y. 2004); *In re NETtel Corp.*, 289 B.R. 486 (Bankr. D. Colo. 2002), this Court will address the analysis of the so-called proration courts in support of their contrary conclusion. By addressing these issues, this Court will better explain its view that the *Montgomery Ward* court correctly decided this issue.

First, most courts adopting the proration approach have concluded that the statute is ambiguous. *See, e.g., In re NETtel Corp.*, 289 B.R. 486 (Bankr. D. Colo. 2002); *In re Learningsmith, Inc.*, 253 B.R. 131 (Bankr. D. Mass. 2000); *In re Child World, Inc.*, 161 B.R. 571 (S.D.N.Y. 1993). Of course, once found ambiguous, those courts then look to the legislative history of § 365(d)(3) and the pre-Code practice of proration in support of their conclusion that proration is the better rule under the Code. For example, in finding the statute ambiguous, the *Ames Dep't Stores* court looked to certain words or phrases used in § 365(d)(3) and concluded that the word "'arises' can be construed to mean having arisen in (a) absolutist terms or (b) in an accrual sense" and that the phrase "until such lease is assumed or rejected" can be construed to modify either the

word "perform" or the word "obligations." *Ames Dep't Stores*, 306 B.R. at 67. According to the *Ames Dep't Stores* court, because § 365(d)(3) can be construed in two separate, but reasonable ways, the statute is ambiguous, thereby allowing reference to the legislative history of § 365(d)(3) and other Code provisions for proper construction and context, and leading to the "straightforward" conclusion that proration is appropriate. *Id.* at 68.

Unfortunately, this Court finds the premise underlying the alleged ambiguity flawed. Even assuming that the word "arises" can reasonably be construed in an "accrual sense" as the *Ames Dep't Store* (and many other) courts conclude, Congress chose not to use the word "accrue" in § 365(d)(3). Congress knew how to use the word "accrue" in the Bankruptcy Code when it intended to provide for something which accumulates periodically. *See, e.g.*, § 522(d)(8)(providing certain exemptions for *accrued dividends or interest* under an unmatured life insurance contract owned by the debtor on the debtor's life or the life of an individual upon who the debtor is a dependent); § 550(e)(1)(A)(providing a lien to a good faith transferee of property in the lesser amount of the cost of improvements to the property less any profit realized by or *accruing* to such transferee from the property and any increase in value to the property as a result of the improvement); & § 761(10)(A)(ii)(defining "customer property" to include profits or contractual or other rights *accruing* to a customer as a result of a commodity contract). However, Congress chose not to use the word "accrue" in § 365(d)(3). Since it is generally presumed that Congress acts intentionally and purposely when it includes particular language in one section of a statute but omits it in another, *BFP v. Resolution Trust Corp*., 511 U.S. 531 (1994), Congress must have meant something different than periodically accumulated amounts in § 365(d)(3).

The starting point in discerning Congressional intent is the existing statutory text, and not the predecessor statute. "[W]hen the statute's language is plain, the sole function of the courts – at

least where the disposition required by the text is not absurd – is to enforce it according to its terms." *Lamie v. United States Tr.*, 124 S. Ct. 1023, 1030 (2004). The fact that the statute is awkward, and even ungrammatical, does not make it ambiguous. *Id.*

The words "arise" and "arising" are not defined in the Bankruptcy Code. Thus, Congress apparently used the word "arising" in § 365(d)(3) in its commonly understood sense. *Pioneer Inv. Servs. Co. v. Brunswick Assoc. Ltd. P'ship,* 507 U.S. 380, 388 (1993) ("Courts properly assume, absent sufficient indication to the contrary, that Congress intends the words in its enactments to carry 'their ordinary, contemporary, common meaning.'") (quoting *Perrin v. U.S.*, 444 U.S. 37, 42 (1979)). Black's Law Dictionary defines "arise" to mean "1. To originate; to stem (from) . . . 2. To result (from) . . . 3. To emerge in one's consciousness; to come to one's attention . . . 4. (Of a court) to adjourn; to suspend sitting. Black's Law Dictionary (8th ed. 2004).

When viewed in this context, and given the plain meaning of the words chosen, § 365(d)(3) is not ambiguous[3] and requires that a debtor timely perform all obligations that arise (in an absolute, non-accrual sense) under an unexpired nonresidential real property lease between two points in time – *i.e.*, after the order for relief and until the lease is assumed or rejected by the debtor. If Congress had intended to continue the proration practice under the former Bankruptcy Act when it adopted § 365(d)(3), it could have provided for that result easily by choosing to enact legislation that required the trustee to timely perform all the obligations of the debtor . . . *accruing* from and after the order for relief . . . until such lease is assumed or rejected.

While not expressly finding the statute ambiguous, the court in *In re Handy Andy Home*

[3] The undersigned judge notes that two other judges in the Dallas division have similarly concluded, albeit in different contexts, that § 365(d)(3) is unambiguous. *See Order* entered 4/1/03 in *In re Cafeteria Operators, L.P.*, No. 03-30179-HDH-11 (Bankr. N.D. Tx. Apr. 1, 2003); *Tr.* of hrg. held 3/23/04 (Docket No. 640), 99:12-100:18, in *In re Avado Brands, Inc.*, No. 04-31555-SAF11 (Bankr. N.D. Tx. Mar. 23, 2004).

Improvement Ctrs., Inc., 144 F.3d 1125 (7th Cir. 1998) adopted an accrual-like analysis when it stated

> [t]he quarrel between the parties is over whether Handy Andy's "obligation" under the lease could arise before Handy Andy was contractually obligated to reimburse National for the taxes that the latter had paid. National says no, and this "billing date" approach is a possible reading of section 365(d)(3), but it is neither inevitable nor sensible. It is true that Handy Andy's obligation to National to pay (or reimburse National for paying) the real estate taxes did not crystalize until the rental due date after the taxes were paid. But since death and taxes are inevitable and Handy Andy's obligation under the lease to pay the taxes was clear, that obligation could realistically be said to have arisen piecemeal every day of 1994 and to have become fixed irrevocably when . . . the lease was still in force.

Id. at 1127. However, for the reasons already stated, this Court declines to follow a piecemeal or accrual analysis.

The courts following the proration approach also point to § 365(g) and § 502(g) to further bolster their interpretation of an ambiguous § 365(d)(3). Sections 365(g) and 502(g) work together to cause claims arising from the rejection of unexpired leases to be treated as pre-petition unsecured claims. Therefore, courts adopting the proration approach conclude that § 365(d)(3) ought not to be interpreted in a matter which would convert some portion of what would otherwise be treated as a pre-petition unsecured claim upon rejection to an administrative expense. Significantly, however, § 365(d)(3) is addressing obligations of the debtor under those leases *prior to rejection*. In short, these three Code provisions address different issues. Section 365(d)(3) addresses the debtor's obligation to perform under its unexpired leases post-petition pending a decision to assume or reject, while § 365(g) says rejection constitutes a breach of the leases immediately before the date of the filing of the petition and § 502(g) says that claims arising from rejection shall be allowed in the bankruptcy case as if they arose before the bankruptcy case was filed.

There is no inconsistency among these Code provisions. To be excused from performing

obligations under unexpired leases which arise after the order for relief, a debtor must reject those leases. In that event, §§ 365(g) and 502(g) treat the landlords' claims for breach of the leases as pre-petition unsecured claims. Conversely, if the debtor wishes to assume an unexpired lease, it must (i) cure any outstanding defaults (or provide adequate assurance of a prompt cure), (ii) compensate the landlord for losses resulting from the outstanding defaults (or provide adequate assurance of prompt compensation), and (iii) provide adequate assurance of future performance under the lease. *See* 11 U.S.C. § 365(a). If the debtor is unsure about assumption or rejection, § 365(d)(3) protects the landlord during a debtor's delayed decision making process and requires the debtor to timely perform all obligations that arise under the lease after the order for relief pending a decision to assume or reject. If the debtor ultimately assumes the lease, the debtor is not prejudiced by § 365(d)(3)'s requirement of timely performance because the debtor would be otherwise required to cure any obligations that it had not timely performed as a condition to assumption. But, § 365(d)(3) protects the landlord from a delayed decision making process and a debtor's desire to not make those payments required by the leases that the Debtor is unsure will form a part of its reorganization.

Applying these legal principles here, the Court concludes that the primary relief requested in the Motion must be denied. Regarding 2004 real estate taxes, the Leases do not require the Debtor to escrow for accruing taxes during a tax year. Thus, § 365(d)(3) is simply inapplicable as it only requires the Debtor to timely perform obligations under the Leases which arise after the order for relief and there is no escrow obligation in the Leases.

Regarding 2003 real estate taxes, the Leases require the Lessors to bill the Debtor for those taxes and to submit copies of the underlying tax bills (as received from the taxing authorities) to the Debtor in order to trigger the Debtor's obligation to pay the taxes. Once billed, the Debtor is obligated to pay the taxes "on or before the time that Lessor shall be required to pay real estate taxes

to the taxing authority for such tax year, but if Lessee shall not have received a bill therefor at least fourteen days prior to such time for payment, Lessee shall not be required to make payment until fourteen days after the receipt of such bill." *See* Lease attached as Exhibit A to the Motion at ¶ 9.04.

The Lessors admit that they have not sent bills to the Debtor for the 2003 taxes. *See* Brief of Landlords in Supp. of Mot. to Require Debtor to Perform Lease Obligations Pursuant to § 365(d)(3) or, Alternatively, to Assume or Reject Leases (Docket No. 327), at ¶ 43. To avoid the billing requirement set forth in the Leases, the Lessors argue that the Leases were modified by the parties' practices and that the Debtor became obligated to pay the 2003 taxes before they became delinquent on January 31, 2004. *See id*. at ¶¶ 5, 43. Because there is no evidence before the Court that would support a finding of a modification of the Leases, and because the Debtor's obligation to pay 2003 taxes has not been triggered in accordance with the express terms of the Leases, § 365(d)(3) is not yet applicable to require the Debtor to pay 2003 taxes on the leased premises.[4]

With respect to the alternative relief requested by the Lessors, the Court is satisfied that the Debtor's case is sufficiently complex to require further time for management to make appropriate decisions regarding assumption or rejection of the Leases. Accordingly, the Debtor will not be compelled to make an immediate decision regarding assumption or rejection of the Leases. The Court's prior Orders giving the Debtor until August 28, 2004 to make such decisions will remain in effect.

SO ORDERED.

End of Order

[4]While the Leases were admitted into evidence, no other evidentiary record was made at the hearing on the Motion. Thus, the Court is not sure if the taxes were paid by the Lessors and the Lessors now seek reimbursement from the Debtor, or if the taxes remain payable to the taxing authorities with accumulated penalties and interest for late payment.